



Landfill Gas and Power

4 September 2009

Dr Troy Forward
Manager Market Development and System Capacity
Independent Market Operator
PO Box 7096
Cloisters Square, Perth, WA 6850

Dear Troy

**SUBMISSION ON REVIEW OF ANCILLARY SERVICE REQUIREMENTS,
PROCESS AND STANDARDS**

Thank you for the opportunity to comment on the Ancillary Service Standards and Requirements study by SKM.

LGP interprets the SKM report as broadly confirming that the historical Ancillary Services arrangements were fit for purpose at the time and having served that purpose are now capable of achieving improved economic efficiency by bringing them into line with the current market structure and best international practice. That said, future evolution should recognise that the SWIS is a medium-sized islanded system for which the costs of a real time competitive Ancillary Services market would not be justified.

LGP broadly supports SKM's recommendations and congratulates SKM on a thorough review and readable document. That said, we consider that the final report would have benefited from an editorial read-through and in particular the harmonising of the several references to the magnitude of the benefits available to the Optimised Dispatch Market which differed between the second and third reports.

We comment in detail as follows.

General

LGP acknowledges that the current Ancillary Services Mechanism was developed in a context in which Verve Energy was the dominant generator, and competitive development of the market required a high level of regulation of ancillary services to mitigate its market power. In furtherance of this, a payment scheme was developed which is now widely perceived to be below cost and unreflective of opportunity costs. Moreover, private generators can provide ancillary services only if their prices are demonstrably lower than the payments made to Verve. There is also a further complication caused by the interplay of penalty charges for non-compliance with Resource Plans submitted by private generators, which apply even if they are called to support the system frequency. These factors have impeded private participation in the

provision of ancillary services and have caused Verve to provide the service at a loss, as evidenced by SKM's comparison with equivalent costs in other jurisdictions.

LGP perceives that the tone of the report casts Verve in the position of a beneficiary of being a monopoly supplier of ancillary services with an unfair exemption from submitting Resource Plans. We wish to clarify that Verve supplies the service at a loss in accordance with the Market Rules and while other parties are permitted, in principle, to compete in the supply of ancillary services, they do not take up the opportunity because they would themselves make a loss. On this basis, LGP supports development of competitive procurement of ancillary services with proper safeguards preventing the possible exercise of market power by Verve.

While we note SKM's advice that there is a lack of sufficient competition to support a fully competitive process, we consider it important to facilitate transparent cost reflective pricing as a means of encouraging competition. We also note that in the last two rounds of capacity certification, fast-response gas turbines, including the type assessed by SKM in their modeling, are being increasingly developed. We also note that while progress has been made in requiring a standard form of pricing in order to facilitate price comparison, that process nonetheless locks-in uncertain outcomes and non-commercial returns to Verve. We consider that this is one of the issues alluded to by the State Government's recent statements that some aspects on the Market Rules are to be revised to improve Verve's financial performance.

Regarding Resource Plans, LGP considers that Verve's exemption is warranted in order to allow it to supply ancillary (and balancing) services with maximum flexibility. That said, LGP would also advocate that all Market Generators should, subject to their other obligations such as network support, be permitted to dispatch on a portfolio resource plan basis rather than confining each generator to a dedicated Resource Plan.

LGP also supports the co-optimising of the dispatch of ancillary services with the dispatch of energy within the market, and advocates that there should be no obligation on non-Verve generation to first be dispatched for energy before they are eligible to supply ancillary services.

Other

LGP details its support for other proposals of the SKM report as follows:

- i) Taking full account of ancillary services in the Renewable Energy Generation Working Group. The Federal Government is encouraging a substantial increase in renewable energy generation, and a large proportion of that is likely to be intermittent. This will increase the need for Ancillary Services and creates an imperative that other parties participate in their supply. By extension, this also creates an imperative for reviewing Ancillary Service pricing so as to properly remunerate suppliers, allocate costs to causers and avoid increasing the existing impost placed on Verve. It is especially important that the ancillary service mechanism evolves to facilitate increasing intermittent penetration and should not be permitted to become a barrier.

- ii) Facilitate the dispatch of spinning reserve from all WEM machines, which SKM estimate will significantly decrease the cost of the Optimised Dispatch Market, improve system security with no additional capital investment.
- iii) Encourage technology neutrality in the provision of ancillary services and in particular further develop the participation of Demand Side Management (DSM). In particular, we note that DSM contributes some 50MW of spinning reserve on the basis of legacy contracts. We advocate that other DSM options should be eligible for similar participation; for example, the two Water Corporation desalination plants seem to be of equal merit.
- iv) Consideration of changing the existing “volume” based Ancillary Service determination to a “performance” based determination placed on System Management as a means of ensuring that suitable levels are procured as and when needed. We also note the discussion of overlap between the Technical Rules and the Market Rules. We propose that only one set of rules should have jurisdiction over a particular matter and that where the Market Rules properly have that jurisdiction, the Technical Rules should facilitate compliance rather than mandate it.
- v) Implementation of a penalty regime for failure to provide a declared quantity and standard of Ancillary Service, applying on an equal basis to all suppliers.
- vi) We would further note that the Ancillary Services mechanism should be sufficiently flexible to permit suppliers to optimize their carbon management according to fuel type.

If you require any further information in respect of this submission, please contact LGP’s General Manager Retail, Steve Gould, on 041 250 8291.

Yours sincerely



GRAEME ALFORD
CHIEF EXECUTIVE OFFICER